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Testimony by
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Mr. Chairman and members of the Committee, my name is Craig Zimpher. I am Vice President of Government Relations for the Nationwide Insurance Enterprise, headquartered in Columbus, Ohio. The Nationwide Insurance Enterprise is a group of core insurance companies, including Nationwide Mutual Insurance Company, Nationwide Life Insurance Company, Nationwide Financial Services, Wausau Insurance Companies, etc. Our products range from personal auto, homeowners, commercial/workers' compensation to life insurance, annuities, financial services, and health insurance. Our companies are licensed to engage in the business of insurance in all 50 states. In addition, Nationwide operates an affiliate insurance operation, NECKURA Insurance Company in Germany and other parts of Europe.

I am honored to be with you today and intend to discuss the Nationwide Insurance Enterprise's perspective on financial services modernization. These issues are significant and have vast public policy ramifications as they affect the financial security of millions of Americans. Specifically, I would like to discuss the regulatory structure of the new financial services world and the need for true functional regulation.

Nationwide believes that expansion of banking powers into the insurance business, absent state regulation of such business, as currently provided in all 50 states would be misguided. We believe, due to decades of business regulation by the states, as Congress mandated in the 1940's through the McCarran-Ferguson Act, that state insurance regulation works effectively and efficiently for both those regulated and those protected, the consumers. To preempt the bank-owned insurance operations from such regulation would disrupt and distort the insurance marketplace across the country.

The Nationwide Insurance Enterprise strongly endorses appropriate safeguards and provisions for state regulation of insurance products, regardless of risk bearer or distributor of such products. Our concern about bank preemption from insurance regulation has been heightened by a series of rules and opinions issued by the Comptroller of the Currency. Over the past several years, these rules have unilaterally expanded insurance authority of national banks. For example, these rules have:

$ Interpreted existing statutory authority of small town banks to sell insurance in rural areas in a way that permits money center banks with branches in small towns to sell insurance nationally.

$ Concluded that municipal bond guarantee insurance could be issued by national banks as Astandby letters of credit.@

$ Concluded that mortgage completion insurance could be issued by national banks as Adebt cancellation contracts.@

$ Pronounced that annuities are not insurance and can therefore be sold by national banks without limitation.

$ Pronounced that banks will have the opportunity to engage in non-banking activities, including insurance underwriting, through downstream operating subsidiaries.

This last development, known as the final Operating Subsidiary Rule, is the most serious expansion of regulatory power yet undertaken by the OCC. The purpose of the these regulations is to provide banks with the opportunity to engage in non-banking activities through downstream operating subsidiaries.

The Op-Sub rules, as they have become known, are purposely vague when it comes to who would regulate a bank=s insurance subsidiary. What the OCC states is that certain safeguards would be imposed on an operating subsidiary engaging in activities not permissible for the bank, including requiring the operating subsidiary to be adequately capitalized under Arelevant industry measures@. However, it is unclear *what* industry measures are intended to apply and *which* regulatory entity would be applying them. Moreover, certain prohibitions on affiliated transactions will apply, but the rules do not go so far as to prohibit tie-in sales.

The Op-Sub rule makes it very clear that the OCC will consider any application from banks to engage in any Anon-bank@ activities, including insurance underwriting. Furthermore, taking a cue from its past actions, the OCC could very well use these rules to establish itself as the regulator of all bank operating subsidiaries, including insurance subsidiaries. I believe that the OCC overstepped its authority when it issued its Op-Sub rule and that their rule, absent any other clear expression of Congressional intent, may very well serve as the foundation for future and drastically expanded erosion of state insurance regulation and consumer protection.

The OCC is considering whether to pre-empt the recently enacted Rhode Island Financial Institution Insurance Sales Act, which governs bank sales of insurance in the state. The Rhode Island law embraces basic consumer protection concepts, protects against coercive sales practices, assures a level playing field, and maintains the regulation of insurance sales and other activities at the state level. The Rhode Island law repealed a prior statute which prohibited banks from engaging in the sale of most insurance products, except credit life, credit accident and health, group credit, group mortgage cancellation life, or group mortgage accident and health insurance. Nevertheless, the OCC seems to believe that the law may not conform to its very broad construction of the U.S. Supreme Court=s decision in *Barnett Bank v. Nelson*.

Under any objective reading, the Rhode Island law and the draft regulations clearly adhere to *Barnett*, as well as to provisions of the federal National Bank Act, in that the law neither prevents nor significantly interferes with a national bank=s ability to exercise its insurance sales authority under federal law. This episode clearly points out that Congress needs to revisit the OCC=s Aexplicit authority@ granted it under Section 92 of the National Bank Act to preempt a state statute that guarantees banks the right to sell insurance, while also guaranteeing consumer basic protections under state law.

The OCC has also begun to expand the boundaries of such a well-settled area as whether banks can sell insurance in Atowns of 5,000". In November 1996, the OCC approved a bank=s application to establish operating subsidiaries to engage in general insurance agency activities pursuant to the town of 5,000 provision; the OCC did so while concurrently expanding the provision. A plain reading of the law, placed in the proper historical context, shows that national bank branches located in a town of 5,000 or less may sell insurance to potential and existing customers in the town. Reasonably, one would assume that this means that a bank would service the residents of the Alocal@ community, since it was clearly Congress= intent that small, rural communities should have access to insurance products.

I am confident that Congress never envisioned that banks would or should use the small town branch provision to become a loop-hole allowing them to Amass market@ state-wide, or potentially nationally, through mailings, telemarketing mills, the Internet, etc. However, that is exactly the current view taken by the OCC. All the OCC requires of a national bank is that its insurance agency subsidiary be Abona fide@, which presumably means licensed, and located in a town of 5,000 or less where the parent bank has a branch. Once they have met these criteria, they may be free to sell anywhere in the country.

It should be abundantly clear to everyone by now that the OCC is engaged in a policy of incremental preemption of state insurance regulation, while expanding its own regulatory power. This policy is one that benefits national banks at the expense of consumers, agents and insurers, creating anything but a level playing field.

We strongly believe that if banks engage in any phase of the insurance business, it should be conducted on a level playing field. To pre-empt state regulation or exempt the banking industry from state regulation of insurance is not a two-way street...it is not even a one-way street...it would be nothing more than a cul de sac... which would not provide consumers with adequate protections. Regulation of financial services must be focused on the specific function being performed and not on the corporate form.

True functional regulation focuses on the activity rather than the entity engaged in that activity. Under functional regulation, bank regulators regulate banking and the states regulate insurance activities, regardless of whether the activity is being conducted in a bank or an insurance company. Bank regulators lack the specialized experience and expertise needed to regulate the insurance activities of banks effectively, just as insurance regulators are not competent to regulate banking activities of insurance companies or their affiliates.

Functional regulation is necessary to protect consumers and create a level playing field; given the recent history of federal regulatory and court decisions, it is clear that this can only be accomplished through federal legislation. Such legislation should provide that all insurance products and activities shall be regulated by state insurance departments. Legislation should also prohibit state insurance regulation that discriminates against banks.

State regulation has a two-fold purpose. First, it is designed to assure that insurance providers treat customers fairly. Second, it is designed to protect consumers, and their long term financial needs, through the financial regulation and oversight of insurance companies.

During the last several years, significant strides and progress have been made in standardizing financial reporting and monitoring requirements. Minimum standards of insurance company capitalization to assure individual company solvency are in place. These capitalization requirements differentiate among insurance product lines and their associated degrees of risks. Included in these standards are specific reserving requirements for various types of claims with which companies must comply. If banks were to be preempted or exempt from state insurance regulation, such as the one I just noted, such reserving or other solvency provisions of state law would not be applicable to banks, therefore allowing much greater capital or surplus flexibility and liquidity for them, creating an extremely dangerous situation for the public.

All states have rate regulations laws that assure insurance rates are not unfair, excessive, or inadequate. Exemption from such rate regulation would, it is so obviously clear, create a unfair and unlevel competitive environment in a particular state.

Through various Amarket conduct@ regulations the various insurance departments of this country have promulgated a series of requirements and regulations designed to ensure that agents and companies comply with state laws and regulations in the marketplace. Market conduct laws and regulations apply to insurance practices and operations including: insurance nonrenewals and cancellations; review of agent conduct and activities; claims handling and processing procedures; assure compliance with unfair claims practices provisions; individual company underwriting practices; and assurance that appropriate rates are being charged for various lines of insurance. Such state regulation ensures that insurance products are being offered in a way so as not to create discrimination, that fair and prompt claims handling practice are being adhered to, and to assure that honest marketing and sales practices are conducted. The fact is that these regulations effectively serve to protect the consumers and assure the long term financial viability of those offering customers insurance products.

One additional feature unique to the state regulatory scheme has been the development and successful operation of state guaranty funds. These funds, including both property and casualty and life insurance products, are in place in the various states and are funded by assessments of existing insurance companies. They are designed to protect and assure long term protection of policyholders whose insurance companies may have become insolvent. Any company involved in the insurance business must be subject to participation in such guaranty funds.

Subsidiaries of a financial service holding company should not be permitted to disclose customer information to affiliates, unless the customer is given the opportunity to object. If a financial services holding company is permitted to own an insurance agency, and bank affiliates can release information about its customers current insurance carriers, insurance premiums, insurance coverage, renewal date, income, location of risk, etc., to the insurance affiliate, this amounts to a taking for profit of the insurer=s proprietary information by a third party beneficiary. While it is one thing to allow banks the right to market insurance to ALL their bank customers, it is quite another issue to allow banks to target customers from information in their mortgage files in order to Acherry-pick@ the best risks. This would not appear to be prohibited under the tie-in sales restrictions applicable in pending legislation.

The banks are arguing that any state limitations on specific marketing activities of bank insurance affiliates would be unfair discrimination. First of all, this is untrue. There are many examples of laws which affect insurance companies differently because of the corporate structure and those laws are generally not found to be discriminatory. However, we think it is appropriate as a matter of federal banking law to prohibit improper use of customer information. This would avoid insurance regulators becoming involved in the issue and unnecessary litigation in the states on the basis of any anti-discrimination language in the statute.

America does not need a dual system of regulation for insurance products. A steady and sound insurance regulatory system has been in place for decades. State regulation of insurance is getting the job done effectively and efficiently. To exempt insurance products offered by banks from state regulation would be unsound and counter-productive to protecting consumers of insurance products.

However, we have a threshold concern; how can we as mutual insurers participate fully in a post-financial services reform world?

Under current law, the unitary savings and loan holding company is currently the only structural model available for an insurance company to affiliate with a depository institution. Some state laws may prohibit or impede the ability of a mutual insurance company to affiliate with a unitary savings and loan holding company. Additionally, to compound the problem, both H.R. 10 and H.R. 268 would, for all practical purposes, actually eliminate the federal savings association charter. Elimination of the thrift charter, without any corresponding change in the Bank Holding Company Act to permit bank-insurance affiliations would preclude affiliations for mutual insurers. Mutual insurers who wish to compete as equals in a new financial services marketplace must have statutory relief from current barriers.

Mutual insurance companies are incorporated under state law for the benefit of their policyholders. Because mutuals do not have stockholders, they cannot be in a holding company structure, unless domiciled in a state that has adopted a mutual holding company act. Such statutes provide for the conversion of the mutual insurer into a stock company controlled by its mutual holding company parent.

Mutual insurers are subject to a variety of state laws that prohibit or limit the size of an investment the insurer can make in a bank subsidiary. These laws include:

- Legal investment laws that contain quantitative limits on an insurer's investment in subsidiaries or prohibit investment in a bank subsidiary;

- Risk-based capital provisions that require an increase in an insurer's required risk-based capital when redeploying invested assets from cash or bonds to the purchase of bank stock; and,

- National Association of Insurance Commissioners (NAIC) standards for valuation of an insurer's subsidiaries that adversely affect surplus by requiring an immediate write-off of goodwill exceeding 10 percent of surplus and require the write-off of remaining good will over 10 years.

Under current law, there are only two practical ways a mutual insurer could navigate these regulatory shoals in order to affiliate with a depository institution:

- Demutualize; or,

- Create a mutual insurance holding company.

A mutual insurer could demutualize and create an upstream stock holding company, which could form or acquire a bank as an affiliate of the insurance company. However, this is not a solution many mutual insurers would be eager to adopt, as they are either committed to the mutual concept or do not want to undergo the disruption and significant costs posed by demutualization. The second option is to permit a bank and an insurance company to become affiliates of one another and subsidiaries of a parent holding company.

As you know, while the Bank Holding Company Act currently prohibits such affiliations, federal financial services reform proposals would amend that act to allow affiliations and, therefore, preempt state laws. This means that the state insurance laws described previously would not apply to stock companies; however, mutual insurance companies, like Nationwide, still could not avail themselves of the holding company affiliation model, unless they are domiciled in one of the seven states that permit mutual holding companies; these include Iowa, Minnesota, Pennsylvania, Rhode Island, Vermont, Missouri and California.

We would suggest that Congress enact a provision to permit both mutual life and mutual property/casualty insurance companies to redomesticate to a state with a mutual holding company statute in order to affiliate with depository institutions.

In conclusion, Nationwide believes that there are a few critical elements which should be incorporated in any affiliation proposal:

1. All insurance activities would have to be conducted by an entity or entities separate from any depository institution;
2. All such insurance affiliates would have to be subject to all the requirements of the appropriate state insurance regulatory authority;
3. Any structure permitting such affiliations would have to be supplemented by a

grant of reciprocal authority that would permit both stock and mutual insurance companies to engage in the business of banking and other activities in which depository institutions are permitted to engage.

Mr. Chairman and members of the Subcommittee, that concludes my testimony today and I wish to express, on Nationwide=s and my own personal behalf, our deepest appreciation for the opportunity to appear before you today. We stand ready to assist you and other members in any way possible to affect positive and practical reform of the financial services industry. Thank you.